

HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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October 17, 2003

Republican Policies Make States' Fiscal Crisis Worse

Dear Democratic Colleague:

The federal government ran a deficit in 2003 of \$374 billion. Around the country, states are also facing historic budget problems, but without the “luxury” of running huge deficits. Attached is a new report by the House Budget Committee Democratic staff on the states’ fiscal crisis, which is being released in conjunction with today’s Democratic Congressional Leadership forum with Delaware Governor Ruth Ann Minner and Trenton Mayor Douglas Palmer. Our report shows that, instead of helping struggling states, Republican appropriations and tax policies unfortunately make matters worse.

Among other conclusions, the report finds:

- ***Domestic Programs*** — The House-passed appropriations bills for 2004 cut domestic programs by \$10.6 billion below the amount needed to maintain services at the 2003 level.
- ***Education*** — No Child Left Behind Act is \$8 billion short of authorization.
- ***Homeland Security*** — First responder funding cut \$350 million below the enacted level, and port security grants receive \$45 million less than the 2003 enacted level.
- ***Law Enforcement*** — State and local law enforcement assistance is cut by \$390 million (19.2 percent) below the 2003 enacted level, and funding is eliminated for Violence Against Women grants, juvenile crime block grants, and terrorism prevention and response training. Community Oriented Policing Services (COPS) is cut \$295 million (30.2 percent) below the 2003 enacted level.
- ***Tax Cuts and Block Grants*** — Federal tax cuts cause state revenues to decline, and proposals to convert federal programs into capped block grants to states in effect transfer the cost of caring for vulnerable populations to the states.

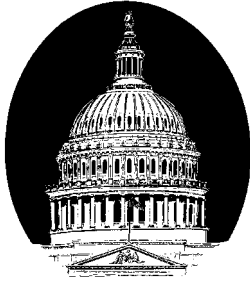
- ***Unfunded Requirements*** — Congress increases state and local government costs by imposing requirements without providing adequate funding to accompany those requirements. We have seen this happen in education with the No Child Left Behind Act and in numerous other areas.

This report provides another illustration of how Republican policies have failed. Those policies have made the states' budget crisis worse, created record federal budget deficits and cost 3.2 million private sector jobs.

If you have any questions on this issue, please call me or the House Budget Committee Democratic staff.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member



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The Budget Crisis for States: How Republican Policies Have Made the Problem Worse

A report by the Democratic Staff of the House Budget Committee
October 17, 2003

This document has not been reviewed and approved by the Democratic Caucus of the Budget Committee and may not necessarily reflect the views of all members.

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Executive Summary

States are facing a fiscal crisis of historic proportions. To balance their budgets, states have been forced to enact hiring freezes, empty “rainy day” funds, borrow against public pension funds, release inmates from prison early, and raid tobacco settlements – but still the shortfalls persist. States must now resort to more severe spending cuts and additional tax increases to close their budget gaps.

This special report, prepared by the Democratic staff of the House Budget Committee, spells out how Republican actions on appropriations bills for 2004 will only make the states’ crises worse. House Republicans have passed the thirteen annual appropriations bills for 2004, cutting domestic funding by \$10.6 billion below the level needed to maintain purchasing power at the 2003 level. This report analyzes the effect of these cuts on states.

But cutting appropriations programs – a multitude of subdued but painful cuts Republicans hope will go unnoticed – is only the tip of the iceberg. Congress imposes mandates on states in areas such as education, social services, and homeland security without corresponding funding commitments. Democrats generally support these mandates but object to the fact that Congress fails to help states pay for them. The purchasing power of flat-funded block grants erodes with each passing year. Federal tax policies send state coffers in the wrong direction, and in turn undermine the economic growth needed to reverse state and federal budget woes. The report also outlines how these Republican policies — unfunded mandates, block grants, and tax policies — plunge states deeper into a fiscal hole.

House-Passed Appropriations Levels Fall Far Short

Because of misplaced priorities within the Republican budget, the appropriations bills fail to adequately fund priority programs on which state and local governments rely. While Republicans made room in their budget for a \$1.3 trillion tax cut for the wealthiest Americans, they would not accommodate the resources needed to fund programs important to states and localities.

The House of Representatives has passed the thirteen annual appropriations measures, providing funding for programs important to states at levels far below amounts needed to maintain purchasing power at the 2003 level. Overall, the level of domestic appropriations provided by House-passed bills falls short by \$10.6 billion. The following are some examples of these funding shortfalls.

- ***No Child Left Behind Act Is \$8 Billion Short*** — The House-passed Republican appropriations bill provides \$8 billion less than what Congress and the President said was needed to support No Child Left Behind next year. For example, the Act authorizes \$18.5 billion for Title I, but the House funding bill provides only \$12.3 billion. The Act authorizes \$1.7 billion for after-school programs, but the House funding bill provides only \$1.0 billion.

- ***Shortchanging First Responders*** — The conference report on appropriations for the Homeland Security Department combined with the House-passed Commerce-Justice-State appropriations bill results in cuts to first responder funding of \$350 million below the 2003 enacted level. This funding gap comes at a time when, according to a report by the Council on Foreign Relations, fully funding the nation's first responder needs will require nearly \$20 billion per year in additional funding over the next five years.
- ***Too Little for Port Security Grants*** — The Homeland Security Appropriations conference report provides only \$125 million for port security grants — \$45 million less than the 2003 enacted level — despite the fact that the Coast Guard reports that \$4.4 billion is needed for this purpose.
- ***State and Local Law Enforcement Assistance*** — The House 2004 Commerce, Justice, and State Appropriations bill provides \$1.6 billion for state and local law enforcement assistance, a \$390 million (19.2 percent) cut below the 2003 enacted level, and a \$416 million (20.2 percent) cut below the amount needed to maintain constant purchasing power at the 2003 level. The bill eliminates Violence Against Women grants, juvenile crime block grants, and terrorism prevention and response training. In addition, the bill substantially cuts Edward Byrne formula grants.
- ***Community Oriented Policing Services (COPS)*** — The House 2004 Commerce, Justice, and State Appropriations bill provides \$683 million for the COPS program, a \$295 million (30.2 percent) cut below the 2003 enacted level, and a \$308 million (31.1 percent) cut below the amount needed to maintain constant purchasing power at the 2003 level. The bill achieves this cut in part by eliminating the following COPS programs: the hiring component; the interoperable communications program; the safe schools program; and the Crime Identification Technology Act program.

Other Republican Policies Make States' Budget Crisis Worse

Congressional Republicans fail to assist states in ways other than insufficient appropriations. By increasing requirements for states and localities without providing the corresponding funding, creating block grants, and pursuing misguided tax policy, the Republican budget answers states' pleas for help with proposals that only do more damage.

Introduction

States are facing a fiscal crisis of historic proportions. In fiscal year 2003, 37 states cut already enacted budgets by a total of \$14.5 billion, and governors in 29 states recommended tax and fee increases of \$17.5 billion for 2004.¹ State governments have enacted hiring freezes, emptied “rainy day” funds, borrowed against public pension funds, released inmates from prison early, and raided tobacco settlements. States now must resort to more severe spending cuts and additional tax increases to close their budget gaps.

States continue to struggle, and recent Republican actions on appropriations bills for 2004 will only make the situation worse. Republicans in the House of Representatives have passed the thirteen annual appropriations bills for 2004, cutting domestic funding by \$10.6 billion below the level needed to maintain purchasing power at the 2003 level. Much of federal support for the states is delivered through these appropriations, and states will be forced to make up the difference when important programs are underfunded, further squeezing already strained budgets. The appropriations bills cut dozens of programs important to states, and when the cuts are totaled and the effect is multiplied over the course of several years, the result is even more destructive.

Democrats Recognized States’ Fiscal Straits

Yielding to Democratic pressure, Republicans included \$20 billion for state fiscal relief in their economic stimulus bill in March 2003 (P.L. 108-94). The plan put forward by the Democrats, however, would have provided \$31 billion for states, including funds for homeland security, Medicaid, infrastructure, and other critical needs.

But cutting benefits – through a multitude of subdued but destructive appropriations cuts Republicans hope will go unnoticed – is only the tip of the iceberg. Congressional directives in areas such as education and homeland security are imposed on states without corresponding funding commitments. The purchasing power of flat-funded block grants erodes with each passing year. Federal tax policies send state coffers in the wrong direction, and in turn undermine the economic growth needed to reverse state and federal budget woes.

Time and time again, Republican policies exacerbate problems for states through underfunded appropriations bills, misplaced budget priorities, and tax proposals that favor the most fortunate. This report addresses all three of these problems.

Appropriations: House-Passed Levels Fall Far Short

Because of misplaced priorities within the Republican budget, appropriations bills do not provide the needed resources to fund priority programs on which state and local governments rely. While Republicans made room in their budget for a \$1.3 trillion tax cut for the wealthiest

¹National Governors Association and National Association of State Budget Officers, *The Fiscal Survey of States*, June 2003.

Americans, they did not accommodate the resources needed to fund programs important to states and localities. In the thirteen annual appropriations measures, the House of Representatives provided funding for programs important to states at levels far below amounts needed to maintain purchasing power at the 2003 level; in many cases they make outright cuts below the 2003 level. The level of domestic appropriations provided by House-passed bills falls short by \$10.6 billion below the level needed to keep pace with inflation. Following are some examples of how these Republican cuts will worsen already tough budget choices for states.

Education – \$8 Billion Needed For No Child Left Behind

Title I funding for economically disadvantaged children, Pell Grants, and special education programs comprise 60 percent of this year's appropriation for the Department of Education. The need to support these programs only increases when the economy slows. As more families have declining incomes, more children qualify for Title I funding and more high school graduates become eligible for Pell Grants. Tightening the purse strings on these and other programs now could hold these students back for the rest of their lives.

No Child Left Behind Act Is \$8 Billion Short — In January 2002, President Bush signed the No Child Left Behind Act and promised to support the funding necessary to implement it. The law raises the goals for student achievement in the country's elementary and secondary schools, and imposes substantial mandates. For 2004, it authorizes \$32 billion to aid economically disadvantaged students — to train teachers, to reform failing schools, to fund after-school programs, to keep students safe, and much more.

However, the House-passed Republican appropriations bill provides \$8 billion less than what Congress and the President said was needed to support No Child Left Behind this year. For example, the Act authorizes \$18.5 billion for Title I, but the House funding bill provides only \$12.3 billion. The Act authorizes \$1.7 billion for after-school programs, but the House funding bill provides only \$1.0 billion.

No Child Left Behind promised to raise student achievement by training teachers and reducing class sizes. Instead, because of a lack of funding, classes are getting bigger, schools are closing earlier, cities are eliminating summer school, and school districts are laying off teachers and staff. According to the National Education Association, the following examples are illustrative of cuts occurring across the country:

- Cleveland cancelled all summer school classes this year.
- Buffalo lost 276 teachers and 250 other school staff, and closed two elementary schools and one high school.
- Oklahoma has fired at least 1,000 teachers and is allowing 11 school districts to create classes of 30 or more students, exceeding the state's class size limit.
- Almost half of Oregon school districts are shortening the school year by days or weeks.
- South Carolina laid off 2,000 teachers, causing many high schools to have average class sizes of 35 students.
- Florida has eliminated two thirds of its pre-kindergarten programs.

Republicans Freeze Pell Grants — The economic downturn is causing many states to cut their education budgets and raise tuition at state colleges and universities. However, instead of raising the maximum Pell Grant for 2004 to meet the growing need, the House bill freezes the maximum award at the 2003 level of \$4,050.

This will leave college students in the lurch across the country. The need for Pell Grants is growing, not shrinking, as state universities across the country raise tuition and fees. For example, the National Association of State Universities and Land-Grant Colleges has compiled a list of increases in tuition and fees planned for this fall, including:

- University of Massachusetts at Amherst will charge \$7,482, up 15 percent;
- University of Virginia will charge \$6,149, an increase of 19 percent;
- Iowa State will charge \$5,028, an increase of 22 percent; and
- Texas Tech University will charge \$4,745, an increase of 23 percent.

Homeland Security – First Responders, Port Security Cut By Hundreds of Millions

Shortchanging First Responders — State and local governments receive funds for first responders from both the Department of Homeland Security (Office of Domestic Preparedness grants, Emergency Management grants, and Firefighter grants) and from the Justice Department (COPS grants, the Local Law Enforcement Block Grant, and Byrne Grants). The Homeland Security appropriations bill conference report roughly matches the 2003 enacted level for Department of Homeland Security first responder grants, and the Commerce-Justice-State bill passed by the House cuts Justice Department first responder funding substantially. If the House levels in the Commerce-Justice-State bill become law, the total cut to first responder funding will be \$350 million below the 2003 enacted level. Notably, this funding gap comes at a time when, according to a report by the Council on Foreign Relations, fully funding the nation's first responder needs will require nearly \$20 billion per year in additional funding over the next five years.

Too Little for Port Security Grants — Port security grants from the Transportation Security Administration (TSA) provide funds for port agencies — including state and local governments — to install the fencing, surveillance technologies, and other measures needed to prevent terrorists from gaining access to docks and other port facilities. The Homeland Security Appropriations conference report provides only \$125 million for port security grants — \$45 million less than the 2003 enacted level — despite Coast Guard reports that \$4.4 billion is needed for this purpose. Since September 11, only about 10 percent of this total has been appropriated for port security grants. During House subcommittee and committee markup of the Homeland Security Appropriations bill, Republicans rejected an amendment offered by Appropriations Committee Ranking Member David Obey that would have added \$500 million for port security grants.

Health – Public Health Programs Frozen

Republicans Erode Public Health Programs Important to States — The House appropriations bill provides negligible funding increases, or freezes funding at the 2003 enacted level, for a number of public health programs. These funding levels fail to take into account inflation, and are therefore a cut from the amount needed to maintain purchasing power at the 2003 level.

- ***Maternal and Child Health Block Grant*** — Funding is cut by \$7 million from the amount needed to maintain purchasing power at the 2003 level, although the President requested a \$21 million increase. Approximately 80 percent of MCH funding goes directly to states in the form of grants. In its budget request, the Department of Health and Human Services pointed out that the recent downturn in state economies and the events of September 11 have increased demand for MCH services, which include direct health care, evaluation and counseling, and other services for mothers, adolescents and children.
- ***Ryan White AIDS Programs*** — The programs receive a 0.3 percent increase over the 2003 enacted level - essentially a freeze in funding. When compared to the level needed to maintain the purchasing power at the 2003 level, the bill cuts funding by \$22 million. Of particular interest to states and localities are Emergency Relief Grants, which provide funds to metropolitan areas that are severely affected by the HIV epidemic. The bill freezes these grants at the 2003 enacted level, a cut of \$9 million from the amount needed to maintain purchasing power.
- ***Healthy Start*** — Funding is frozen at the 2003 enacted level of \$98 million. Healthy Start provides grants to communities with high rates of infant mortality. These programs have made great strides in helping at-risk mothers have healthy babies. The freeze in funding will limit the program's ability to reach more at-risk women and communities.
- ***Preventive Health and Health Services Block Grant*** — Funding is frozen at the 2003 enacted level of \$134 million, a \$2 million cut from the level needed to maintain purchasing power. The vast majority of preventive health block grant dollars (94 percent) go directly to communities to address public health problems via programs such as blood lead testing for uninsured children and hearing loss screenings for newborns.
- ***Immunization Grants*** — The grants receive no increase in resources, with funding frozen at \$651 million. In the Appropriations Committee report's dissenting views, Congressman Obey points out that this program has had trouble keeping up with the cost of immunizing children, with 19 states reporting that they did not have enough funds to purchase the pneumococcal conjugate vaccine for their clinics last year. This popular vaccine is effective in preventing meningitis, bacterial blood infections, and ear infections. The House bill also provides only half of the money that the President requested to prepare for an influenza pandemic.

Republicans Cut State Offices of Rural Health — The House appropriations bill cuts funding for the State Offices of Rural Health by over 50 percent. These offices strengthen rural health

care delivery systems by providing information and technical assistance to rural providers, and working with rural communities to recruit and retain health professionals.

Department of Justice – Almost \$1 Billion Slashed From Law Enforcement

Additional Republican Cuts in State and Local Law Enforcement Assistance — State and local law enforcement assistance programs center on combating and deterring crime. House Republicans provide \$1.6 billion for state and local law enforcement assistance for 2004, a \$416 million (20.2 percent) cut below the amount needed to maintain purchasing power at the 2003 level. The appropriations bill eliminates Violence Against Women grants, juvenile crime block grants, and terrorism prevention and response training. In addition, the bill substantially cuts Edward Byrne formula grants, which help state and local law enforcement fight drugs and improve the criminal justice system, as well as equip and train personnel to combat terrorism.

Republicans Drastically Cut COPS — The Community Oriented Policing Services (COPS) provides grants and other assistance to help communities hire, train, and retain police officers and improve law enforcement technologies. The House 2004 Commerce, Justice, and State appropriations bill provides \$683 million for the COPS program, a \$308 million (31.1 percent) cut below the amount needed to maintain purchasing power at the 2003 level. The bill achieves this cut in part by eliminating the COPS hiring component, which puts new officers on the street; the interoperable communications program, which provides technologies that enable different law enforcement agencies to communicate with one another; the safe schools program, which provides law enforcement technology and personnel to provide protection in schools; and the Crime Identification Technology Act program, which provides tools to help law enforcement identify criminals and victims, thereby enhancing prosecutions.

Transportation – Republicans Provide Only Half of What Amtrak Needs

Republicans Cut Federal Support of Amtrak and Shift Burdens to States — House Republicans matched the President's 2004 request for aid to Amtrak by providing \$900 million. For 2003, Congress provided just over \$1.0 billion and postponed Amtrak's repayment of a \$100 million loan. The 2004 funding is just half of what Amtrak's president has stated that the company needs in federal support to keep rail service operating. The President's \$900 million request is part of his plan to restructure Amtrak and shift much of the responsibility for passenger rail service to the states. In the current fiscal environment, most states cannot afford to shoulder this additional burden, and are apt to eliminate many Amtrak routes outside the Northeast corridor instead.

Environmental Protection – Cut Over Half a Billion From Current Level

Cut Aid for Wastewater Infrastructure — Both the President and House Republicans advocate large cuts to the Environmental Protection Agency’s Clean Water State Revolving Fund Program. This program provides seed money to state revolving funds, which in turn loan money to localities for improvements to wastewater treatment facilities. For 2004, the President’s budget provides \$850 million for the program, \$503 million (36.4 percent) below the level needed to maintain purchasing power at the 2003 level. House Republicans improved on the President’s request by providing \$1.2 billion for the program, but this is still \$153 million (11.3 percent) less than the amount needed to maintain purchasing power at the 2003 level.

Reports by the Environmental Protection Agency, the Congressional Budget Office, and others document a huge unmet need for improvements to wastewater infrastructure that will not be met without continued federal investment.

Housing – Cut Over Half a Billion From Current Level

Republicans Eviscerate Program to Rehabilitate Dilapidated Public Housing — House Republicans provided only \$50 million for the HOPE VI program, a reduction of \$520 million, or 91.2 percent, from the 2003 funding level of \$570 million. The HOPE VI program provides funding for the demolition or rehabilitation of severely distressed public housing projects. Local authorities have successfully used HOPE VI funds to leverage private investment and transform dilapidated areas into thriving mixed-income neighborhoods that generate more economic activity.

Republicans Erode Funding for Public Housing — The House-passed bill to fund public housing programs fails to provide sufficient resources to keep pace with inflation in several key areas. The bill provides \$3.6 billion for the public housing operating fund, \$24 million less than is necessary to maintain services at the 2003 level. The bill also cuts the public housing capital fund by \$35 million below the amount needed to maintain 2003 service levels. These cuts will hurt local housing authorities’ ability to repair and maintain housing units, which ultimately threatens to reduce the number of low-income working families who will be able to obtain affordable housing.

Social Services – Large Cuts To Programs That Help People On the Edge of Poverty

Republicans Cut Low-Income Home Energy Assistance — House Republicans voted to provide \$1.8 billion for the Low-Income Home Energy Assistance Program (LIHEAP), which is about \$200 million less than the total amount (including carryover funds) available this year. Meanwhile, natural gas prices are projected to rise this winter by 50 percent above last winter’s

prices.² The Republican funding level will reduce the states' ability to provide extra assistance to low-income families in the event of contingencies such as disasters or significant increases in unemployment or energy costs.

Republicans Cut Community Services Block Grant by One Quarter — Appropriations Committee Ranking Member David Obey noted that the House Labor-HHS-Education appropriations bill does not increase funding for even one single safety net program, and cuts funding for several programs. For example, the bill cuts the Community Services Block Grant to \$495 million, almost 25 percent below the amount needed to maintain services at the 2003 level. This grant provides important services to reduce poverty through housing assistance, nutrition, emergency services, energy, substance abuse assistance, education, and employment.

Community and Regional Development

Community Development Financial Institution Fund (CDFI) — The CDFI program provides grants, loans, and other assistance to promote investment in economically distressed areas. The House 2004 Veterans Affairs and Housing and Urban Development appropriations bill provides \$51 million for the CDFI program, a \$24 million (32.0 percent) cut below the 2003 enacted level.

Rural Community Advancement Program (RCAP) — The Rural Community Advancement program provides grants, loans, and loan guarantees to stimulate economic growth and build facilities in rural communities. The House and Senate 2004 Agriculture appropriations bills provide \$706 million for the RCAP, a \$196 million (21.8 percent) cut below the 2003 enacted level.

Empowerment Zones and Enterprise Communities — Empowerment Zones and Enterprise Communities target funds to revitalize economically distressed urban and rural communities and attract private investment in those communities. The House Republicans provide only \$15 million for empowerment zones and enterprise communities, a \$15 million (50.0 percent cut) below the 2003 enacted level, and \$10.9 million for rural empowerment zones and enterprise communities, a \$3.9 million (26.2 percent) cut below the 2003 enacted level.

New Requirements Dwarf Federal Resources

Congressional Republicans hurt states' budgets in ways other than insufficient appropriations. By increasing requirements for states and localities without providing the corresponding funding, creating block grants, and pursuing misguided tax policy, the Republican budget answers states' pleas for help with proposals that only do more damage.

Republican Budget Imposes Higher Welfare Reform Costs on States, Without Paying for Them — Both the President and House Republicans propose stringent new work requirements

²House Appropriations Committee Democrats, "Labor-HHS-Education Minority Views," July 8, 2003.

for parents receiving welfare cash assistance. The Congressional Budget Office estimates these new requirements will increase state costs for child care and work activities by \$6-9 billion over five years. The Republican budget does not provide anything close to this amount to compensate states for these increased costs.

Instead, the Republican budget freezes funding for the basic Temporary Assistance for Needy Families (TANF) grant to states at the 2003 level of \$16.6 billion, eroding its purchasing power over time. The Republican budget does increase funding for the Child Care Entitlement to States, but by only \$1 billion over five years. The Republicans' refusal to acknowledge the costs of their policies comes at a time when many states are making deep cuts in the very programs that are crucial to help welfare recipients make the transition to work.

For instance, several states are cutting welfare-to-work programs, intensive case management for people facing the most severe barriers to employment, transportation assistance, and child care assistance.³ States are no longer experiencing steep declines in their TANF cash-assistance caseloads that would free up resources for other uses, such as child care. In fact, since the start of the recession in March 2001, caseloads have increased in 29 states.⁴

Special Education Remains Underfunded — Despite recent increases, federal funding covers only 18 percent of the average per pupil expenditure for all children with special education needs, far short of the 40 percent maximum that Congress authorized in the Individuals with Disabilities Education Act. The House-passed appropriations for 2004 include a federal contribution of about 19 percent, still less than *half* of “full funding.”

A Block Grant By Any Other Name Still Does Not Smell Sweet

The Bush Administration and Congressional Republicans have proposed converting a range of existing programs into block grants, although they disguise the block grants with labels such as “allotments,” “demonstrations,” or “opportunities for state coordination.” While block grants are usually proposed under the auspices of providing greater flexibility, the result is often less funding.

In the 2004 budget, President Bush proposed to block-grant several programs that support low-income and working families, including Medicaid, Section 8 housing assistance, and foster care assistance, among others. Congressional Republicans have passed several measures to move Head Start, Food Stamps, and other low-income assistance programs down the path of block grants.⁵ While these block grants may appear attractive to states in the short term, they can end up costing states more in the long run, and hurt the beneficiaries they are meant to serve.

³Center on Budget and Policy Priorities, “States Are Cutting TANF and Child Care Programs,” June 3, 2003.

⁴Center for Law and Social Policy, “Welfare Caseloads in 27 States Decline in First Quarter of 2003,” July 18, 2003.

⁵H.R. 2210, the School Readiness Act of 2003; and H.R. 4, the Personal Responsibility, Work, and Family Promotion Act of 2003.

Block Grants Result in Diminished Program Resources, Shifting Financial Burden to States

— Block grants often result in less resources through immediate and explicit funding cuts or a slow erosion in the program's purchasing power over several years. Converting a program to a block grant can doom it to a future of funding freezes. Recent block grant proposals clearly embrace this strategy of program starvation.

- ***Medicaid*** —The President's Medicaid block grant proposal would end the current federal-state financial partnership whereby the federal government agrees to pay for a fixed proportion of state Medicaid costs. The President's proposal would cap the amount of federal funds available for health coverage for millions of low-income children, parents, pregnant women, elderly and disabled individuals. While the capped "allotment" may increase annually based on current spending projections, there is no guarantee that the federal contribution will be adequate to keep pace with actual financial or beneficiary needs. For example, the need for adequate federal funds could be significantly greater than projected for any number of reasons, including an economic downturn, increased unemployment, demographic changes, epidemics, new health care technologies, or simple forecasting errors. Capping federal funding would merely shift the burden to low-income Americans and states, leaving states no choice but to scale back Medicaid coverage for millions of vulnerable Americans.
- ***Section 8 Housing Vouchers*** — The President's proposal to convert Section 8 housing vouchers into a block grant to states provides no mechanism to ensure that the annual federal funding will keep pace with housing costs, which have grown faster than inflation in many parts of the country in recent years. If Congress fails to provide sufficient funding to keep up with costs, states will either have to serve fewer families or reduce the value of the vouchers, effectively making housing unaffordable for more low-income families. Either way, low-income families will be worse off unless states spend more of their own scarce resources on housing to offset the decline in federal assistance. Congress now funds Section 8 based on the estimated cost of continuing all vouchers currently in use, plus any incremental costs if Congress chooses to increase the number of vouchers. Only about one out of four eligible families now receives any federal housing assistance; most local housing authorities have long waiting lists for housing vouchers.
- ***Temporary Assistance for Needy Families*** — Congress created Temporary Assistance for Needy Families as a welfare block grant to states in 1996 to replace Aid to Families with Dependent Children, which had been an entitlement to individuals. Funding for the basic family assistance block grant to states and territories was set at \$16.6 billion per year and has stayed flat since then. In the early years of TANF, a strong economy and declining cash-assistance caseloads allowed states to operate effectively with a flat funding stream, and even to build up cash reserves. Since 2001, however, states have been spending down their reserves to meet program needs. Meanwhile, inflation eroded the purchasing power of the TANF block grant by 12 percent between 1997 and 2002.

The President and Republicans propose to freeze the basic block grant for the next five years, effectively allowing it to wither away in real terms.

By moving to block grants, the federal government limits its financial exposure. More of the responsibility and financial burden for the programs then shift to the states.

“State Flexibility” Means Benefit Cuts — Many block grants are promoted under the auspices of providing more “state flexibility” and encouraging more “state innovation.” Although block grants can lead to effective program developments, by removing federal eligibility and benefit requirements, block grants allow states to change (i.e., cut) benefits, or target different eligibility groups (i.e., cut other groups).

- **President’s Medicaid Proposal** — The President’s Medicaid block grant proposal gives states essentially unfettered flexibility to pick and choose who gets which medical benefit and to impose unlimited cost-sharing on very low-income individuals, rather than guaranteeing affordable, comprehensive health benefits to all eligible beneficiaries.
- **Head Start** — The House-passed reauthorization of Head Start allows states participating in a new block grant program to cut services, increase class size, stop serving 3-year-olds, and shorten the length of the program.

Block Grant Dollars Can Replace State and Other Federal Efforts — In some cases block grants can replace state dollars, or displace other federal money, resulting in less overall funding for the program. This concern in part led to criticism of the House-passed Head Start reauthorization bill, which allows certain states to supplant other federal pre-kindergarten dollars. Another example is the Temporary Assistance for Needy Families block grant, where the General Accounting Office found that substitution of federal dollars for state dollars was a common practice in the ten states examined.⁶ While the freed-up state dollars are often used for related purposes, states can also spend them on unrelated programs - in fact, Wisconsin used this tactic to partially pay for a property tax cut.

Block Grants Can Undermine Federal Support for Programs — As funding and program requirements are turned over to states, it is often difficult to see what the federal dollars are buying. This lack of transparency can result in diminished federal support for programs, resulting in further funding freezes or cuts, and an even greater burden for states. The fate of the Social Services Block Grant (SSBG) provides an example of this risk. SSBG gives funds to states to provide a wide variety of social services, including child care, family planning, protective services for children and adults, services for children and adults in foster care, and employment services. States have wide discretion over how they use SSBG funds, and do not have to provide state matching funds. In past years the lack of information on SSBG-funded

⁶General Accounting Office, *Welfare Reform: Challenges in Maintaining a Federal-State Fiscal Partnership*, August 2001, GAO-01-828.

activities has been used as justification for cutting program funding.⁷ While SSBG was created in 1982 and funded at \$2.4 billion, it is now funded at \$1.7 billion – 60 percent below the 1982 level after adjusting for inflation.

Republican Tax Cuts Undermine Struggling State and Local Governments

The Republican tax-cut agenda creates more problems for states struggling with unprecedented budget deficits. The tax cuts signed into law since President Bush took office widen the gap between state revenues and the costs of state services, making it more difficult for states to provide the services that the public demands. And these tax cuts are only the beginning of the Republican tax agenda, which calls for a total of \$1.3 trillion in tax cuts over the next ten years, on top of the \$1.35 trillion from the 2001 tax-cut law.

The Republican tax agenda will ultimately worsen the fiscal position of states. If tax cuts are not paid for with offsetting federal spending cuts, large structural deficits will drive up interest rates, which will make it more expensive for states and local governments to finance capital investment in roads, schools, sewers and other infrastructure critical to future economic growth. If the federal government pays for its tax cuts by making significant cuts in spending on health, education, social welfare, community development, and other domestic priorities, states and local governments will face pressure to backfill spending on these programs. Either way, state and local governments will be forced to raise taxes to meet these higher costs.

Republican tax cuts will also reduce state revenue collections. The Republican tax cuts already signed into law will reduce state tax collections by billions of dollars next year and beyond. Depending on how future Republican tax cuts are structured, the revenue drain to states may get even worse.

The Federal – State Link

Most states link their individual, corporate, and estate taxes to definitions or provisions used in the federal tax code. This minimizes the taxpayer burden of complying with potentially differing systems of taxation. One consequence of this linkage is that federal tax policy changes often have a “trickle-down” effect on state tax revenues. While states can compensate for some of these effects by de-linking their tax codes from the federal one, doing so can pose significant challenges. In some cases, states may need a legislative supermajority or a popular referendum to approve tax changes. Moreover, requiring taxpayers to calculate their income and taxes differently for state tax purposes would increase the administrative burden on taxpayers, introduce new potential for error, and reduce the potential for federal and state cooperation on tax administration.

⁷H. Rept. 105-205.

The 2001 law's gradual repeal of the estate tax, for example, is estimated to cost states \$16 billion from 2003 to 2007, with losses growing thereafter.⁸ The 2001 law also made a number of other changes that will erode state revenues, such as increasing IRA contribution limits, providing additional tax breaks for education, and liberalizing pension rules.

Increased Cost of State Borrowing

State and local governments generally finance infrastructure spending – such as for schools, transit, universities, hospitals, or clean water projects – by selling bonds and using tax revenues to pay them off over time. These municipal bonds are exempt from federal taxation, which means local governments can offer a lower interest rate and still attract investors. These lower rates help reduce taxpayer costs of building local infrastructure projects that benefit the public and encourage economic growth.

Reducing taxation of corporate dividends paid to individuals puts dividend-paying corporate stocks in direct competition with tax-free government bonds, forcing local governments to pay higher interest rates to attract investors. A study by the California State Treasurer found that most experts predict that exempting dividends from taxation would increase interest rates on municipal bonds by 0.25 to 0.50 percentage points. This would result in state and local governments across the nation paying as much as \$155 billion in increased interest costs over the life of all bonds issued by states and localities over the next ten years.⁹ Taxpayers would have to pay higher taxes or accept the reduced services to cover these costs. Higher interest costs also reduce state and local bonding capacity, reducing the ability of local governments to build enough schools to handle growing enrollments, for example.

Where's the Economic Recovery?

Republicans claim that their tax cuts provide a boost to the economy, and are precisely what is needed when the economy is faltering. While tax cuts on the federal level may seek to boost the economy, Congressional Republicans handicap state budgets with their spending and tax cut strategies, forcing states to make up the difference. If a cut in federal income tax is accompanied by a boost in state and local property, sales, and income taxes, any potential economic jumpstart is lost.

Another factor likely to increase state and local financing costs is the effect of the Republican tax agenda on the federal debt. The 2004 Republican budget resolution assumes tax cuts of \$1.3 trillion. These tax cuts are projected to contribute significantly to large structural deficits that will persist long after the economy resumes strong growth. The resulting federal demand for credit will put upward pressure on interest rates, all else being equal.

⁸Center on Budget and Policy Priorities, "Bush 'Growth Plan' Would Worsen State Budget Crises," January 30, 2003.

⁹California State Treasurer, "No Dividends: How Taxpayers Lose Under the Bush Plan," January 2003.

State Fiscal Crisis Did Not Result from Overspending

Some observers argue that states created their own fiscal mess by going on a spending spree and cutting taxes during the boom years of the late 1990s. States did cut taxes by a total of about eight percent between 1995 and 2001, but they also built up substantial reserves to help deal with future downturns. Reserve fund balances reached a total of \$48.8 billion in 2000, equivalent to about 10.4 percent of state spending, the highest level in more than 20 years. The buildup of these reserve funds contradicts the claim that states were spendthrifts. Prior to the recession of the early 1990s, by contrast, states had accumulated reserve balances equivalent to only 4.8 percent of state spending. Moreover, state spending growth during the late 1990s was in line with historical trends. Annual spending growth from 1995 through 2001 averaged 6.5 percent, consistent with the average over the preceding 25 years.^{/a} Adjusted for inflation and population growth, state spending increased at a slower annual rate in the 1990s (2.0 percent) than the 50-year average annual rate of 2.9 percent.^{/b}

Even though state reserves were at an historical record and spending growth was moderate, the economy and tax revenues – including the influence of Republican tax cuts – have been far worse than in any previous downturn. In fact, the 7.4 percent decline in real state tax revenue per capita is twice as bad as revenue declines seen in the recessions of 1990-91 and 1980-82.^{/c} Furthermore, while rising Medicaid costs have put significantly more pressure than expected on state budgets since 2000, with growth rates of 13 percent in 2002 and 8 percent in 2003^{/d} due to the economic downturn and rising health care costs generally, the precipitous decline in state revenues – which was more than twice as steep as declines during the last two recessions – was a much larger factor in the current state fiscal crisis. The growth in state Medicaid spending exceeded prior trends by about \$7 billion, but this is exceeded nearly nine-fold by the drop in tax revenues, which fell below prior trends by \$62 billion.^{/e}

^{/a} Scheppach, Raymond. “The State Fiscal Crisis Continues,” National Governors Association. <http://www.nga.org/cda/files/062603FISCALCRISIS.pdf>

^{/b} McNichol, Liz. “The State Fiscal Crisis: Extent, Causes, and Responses,” April 24, 2003, Center on Budget and Policy Priorities, Washington, DC.

^{/c} Boyd, Donald. “The Current State Fiscal Crisis and its Aftermath,” September 2003, Nelson A. Rockefeller Institute of Government.

^{/d} National Governors Association and National Association of State Budget Officers. *The Fiscal Survey of States*, June 2003.

^{/e} Donald Boyd, 2003.

More Tax Cuts To Come

Republicans are not even waiting until next year to pursue further tax cuts. In addition to the major tax cut package signed into law in May, several proposals pending in the House would likely cause further erosion to state revenues, although the amount by which state revenues would decline is not known in some instances:

- H.R. 2896, a package of corporate tax cuts, would reduce federal revenues by \$128 billion over ten years.
- H.R. 1776 increases contribution limits to pensions and IRAs, changes distribution rules, and makes other changes affecting pensions. The bill would reduce federal revenues by \$48 billion over ten years.
- H.R. 2596 (appended to H.R. 1, the House-passed Medicare prescription drug bill) creates tax-free health savings accounts. Account contributions would be excluded from pre-tax income. This bill would reduce federal revenues by \$174 billion over ten years. States could lose up to \$30 billion over ten years.¹⁰

While a federal tax cut is not inherently an undesirable policy solely because it causes a reduction in state revenues, federal tax policy must be considered in the larger context of states' economic and fiscal positions, and it must be considered in relation to federal spending decisions that affect states. At a time when individuals are losing health care and teachers are working without pay as states desperately try to close gaping holes in their budgets, it is inadvisable to pursue federal tax and spending policies that drive a bigger wedge between the costs of state and local government services and the resources available to pay for them. Pursuing significant federal tax cuts without considering the implications for states can lead to unintended consequences, counterproductive results, and hidden burdens on state and local taxpayers that may not become evident for years to come.

Conclusion

Republican policies are only worsening the fiscal crisis states are facing. By shearing appropriations for dozens of vital programs, Republicans take yet another step toward worsening states' bottom lines. Republicans combine the appropriations shortfall with additional federal requirements in existing programs, but do not provide additional funding. Frozen block grants erode purchasing power of programs important to states, and Republicans' current and future tax policies burden states further. Instead of helping states in their time of need, Republican policies – on both spending and taxes – are making states budget crises even worse.

¹⁰ Center on Budget and Policy Priorities, "New Health Savings Security Accounts Could Reduce State Revenues By Up To \$30 Billion Over the Next Ten Years," July 8, 2003.